Supreme Court, U.S.
FILED
JAN 16 2015
OFFICE OF THE CLERK
SUPREME COURT, U.S.

Nos. 13-1421 & 14-163

IN THE

Supreme Court of the United States

BANK OF AMERICA, N.A., PETITIONER,

v.

DAVID B. CAULKETT, RESPONDENT.

BANK OF AMERICA, N.A., PETITIONER,

v.

EDELMIRO TOLEDO-CARDONA, RESPONDENT.

On Writs of Certiorari to the United States Court of Appeals for the Eleventh Circuit

BRIEF OF LOAN SYNDICATIONS AND TRADING ASSOCIATION, AMERICAN BANKERS ASSOCIATION, SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION, AND THE CLEARING HOUSE ASSOCIATION L.L.C. AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Whether Section 506(d) of the Bankruptcy Code authorizes a bankruptcy court to compel the holder of a mortgage to relinquish the mortgaged property to the debtor, free of the lien, without full payment of the debt.

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INTEREST OF *AMICI CURIAE* [1]

The Loan Syndications and Trading Association ("LSTA") is a financial trade association whose mission is to promote a fair, orderly, efficient, and growing corporate loan market and to provide leadership in advancing and balancing the interests of all market participants. Its interest in these cases lies in promoting sensible and effective rules for the liquidation and collection of secured loans. Because its members frequently purchase debt in the secondary market, often secured by an inferior lien, their interest in a reasoned resolution of this problem is paramount. Moreover, as a nationwide group with members under the jurisdiction of virtually every federal court of appeals, LSTA has a unique interest in ensuring regularity and predictability throughout the circuits, and especially in uniform rules that promote efficient bankruptcy administration.

The American Bankers Association ("ABA") is the largest national trade association of the banking industry in the country. It represents banks and holding companies of all sizes in each of the fifty states and the District of Columbia, including community, regional, and money center banks. The ABA also represents savings associations, trust companies, and savings banks. ABA members hold approximately 95% of the United States banking industry's domestic assets. The ABA frequently appears in litigation, either as a party or amicus curiae, in order to protect

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[1] This brief was not authored in whole or in part by counsel for a party. No person other than the *amici* made a monetary contribution intended to fund the preparation or submission of this brief. All parties have consented to the filing of this brief.

and promote the interests of the banking industry and its members.

The Securities Industry and Financial Markets Association ("SIFMA") is a member-driven association that brings together the shared interests of hundreds of securities firms, banks, and asset managers. SIFMA's mission is to develop policies and practices that strengthen financial markets and encourage capital availability, job creation and economic growth while building trust and confidence in the financial industry. SIFMA is the U.S. regional member of the Global Financial Markets Association. SIFMA's interest in the stability and availability of capital gives it a strong interest in cases, like this one, that have the potential for adverse systemic impact on commercial lending markets.

Established in 1853, The Clearing House is the oldest banking association and payments company in the United States. It is owned by the world's largest commercial banks, which collectively hold more than half of all U.S. deposits and employ over one million people in the United States and more than two million people worldwide. The Clearing House Association L.L.C. is a nonpartisan advocacy organization that represents the interests of its owner banks by developing and promoting policies to support a safe, sound, and competitive banking system that serves customers and communities. Its affiliate, The Clearing House Payments Company L.L.C., which is regulated as a systemically important financial market utility, owns and operates payments technology infrastructure that provides safe and efficient payment, clearing, and settlement services to financial institutions, and leads innovation and thought leadership activities for the next generation of payments. It clears almost $2

trillion each day, representing nearly half of all automated clearing house, funds transfer, and check image payments made in the United States. *See* The Clearing House's web page at www.theclearinghouse.org.

These cases present the question whether Section 506(d) gives a bankruptcy court the authority to compel the holder of a mortgage to relinquish property to the debtor, free of the lien, without payment in full of the debt. Since this Court's rejection of an almost identical claim twenty years ago in *Dewsnup v. Timm*, 502 U.S. 410 (1992), a framework of reliance built upon that decision has spread throughout the Nation's financial markets. To overturn that framework now – more than two decades later – would destabilize markets still recovering from the economic stresses of the last several years. *Amici* have a direct interest in the stability of that framework; we hope this brief will help the Court understand the disruption to commercial expectations that would follow a reversal of course.

SUMMARY OF ARGUMENT

1. Inferior liens are now, and have been for more than a century, an integral part of the Nation's mortgage lending markets. Although the particular cases before the Court involve inferior liens on residential property, inferior liens are vital to commercial markets as well. The decision in these cases inevitably will ripple through that broader market.

The lenders that advance funds in that market have operated for decades against the backdrop of this Court's decision in *Dewsnup*. Taken on its own terms, the analysis of *Dewsnup* applies as directly to inferior liens as it does to the first lien at issue in *Dewsnup*

itself. Indeed, a contrary rule in this situation would be even more remarkable than it would have been in *Dewsnup*, because it would allow a borrower to retain collateral without paying ***anything*** to the lender. A ruling that validated "lien-stripping" in this context would cause marked and unanticipated disruption to a central sector of our Nation's still-fragile commercial and consumer lending markets.

2. As long as the Nation has had bankruptcy laws, their basic premise has been that "liens pass through bankruptcy unaffected." The details of those laws have changed substantially as the role of the bankruptcy process in managing financial distress has grown, but with a single exception (promptly held unconstitutional by this Court), no statute, outside the reorganization context, has ever compelled a mortgage lender to surrender its collateral to the debtor while the loan remains unpaid. The argument that Section 506 of the Bankruptcy Code implicitly allows the bankruptcy court to strip off a creditor's lien – based solely on the result of a current appraisal, and without the procedural protections that cabin the reorganization chapters – is so foreign to traditional practice that it cannot be countenanced.

ARGUMENT

I. Stripping off Inferior Liens Would Disrupt a Large Sector of the Commercial Lending Market That Justifiably Has Relied on This Court's Interpretation of the Bankruptcy Code.

There is nothing novel or unusual about taking multiple liens to secure different loans on the same piece of real estate. To the contrary, it has been a common practice in this country for more than a

century. This Court's own decisions provide a glimpse of that practice. *E.g.*, *Penn v. Calhoun*, 121 U.S. 251 (1887) (adjudicating priority of second lien against proceeds of a foreclosure sale); *Louisville, E. & St. Louis Railway v. Wilson*, 138 U.S. 501 (1891) (adjudicating propriety of receiver deducting expenses from foreclosure proceeds due to holder of second lien). More broadly, the ubiquity of inferior liens in the 19th Century is plain from the pervasive discussion of the subject in the treatises of the day, which reference ***hundreds*** of reported opinions resolving disputes between competing lienholders.[2] Inferior liens are neither novel nor innovative; they are a cornerstone of lending practice.

Today, inferior liens play a crucial role in any number of markets. These cases involve a second lien in the context of a residential mortgage loan, a type of

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[2] *E.g.*, Charles T. Boone, Law of Mortgages of Real and Personal Property §§ 66-72 (1886) (discussing effects of registration, notice, and agreement on priority between competing mortgage lenders); William Richard Fisher, The Law of Mortgage as to the Redemption, Foreclosure, and Sale in Equity of Property with the Law of the Priority of Incumbrancers ch. vii (1857) (discussing priority between competing mortgage lenders); Leonard A. Jones, A Treatise on the Law of Mortgages of Real Property chs. xii-xiii (5th ed. 1894) (discussing effects of registration and notice on priority between competing mortgage lenders); Darius H. Pingrey, Treatise on the Law of Mortgages of Real Property chs. xviii, xxvi, (2nd ed. 1893) (discussing effects of registration on priority between competing mortgage lenders and the right of a junior lienholder to be subrogated to the rights of senior lienholder); 1 Charles Hasting Wiltsie & James A. Kerr, A Treatise on the Law and Practice of Foreclosing Mortgages on Real Property, and of Remedies Collateral Thereto, with Forms ch. vii (1897) (discussing procedures for foreclosures on property burdened by junior liens).

loan that is not at all unusual.[3] But inferior liens are common in the commercial arena as well. Notwithstanding the capital constraints related to the recent economic downturn, lenders use inferior liens to protect billions of dollars of new loans each year.[4] More than $40 billion of such loans are presently outstanding.[5] The backdrop against which the Court considers these cases should include the commonplace use of inferior liens in the commercial context as well as the residential context directly at issue. The stakes of these cases are high, for their resolution will affect lending decisions of both kinds.

No lender reasonably could have doubted the application of *Dewsnup* to inferior liens – underwater or not. As a glance at the *Dewsnup* opinion demonstrates, neither a lien's priority nor the value of the collateral that secures it has any relation to the logic that grounded this Court's opinion in *Dewsnup*. The Court explained that Section 506(d) invalidated liens only when the underlying claims were disallowed under Bankruptcy Code § 502: "[P]etitioner [can not] 'strip down' respondent's lien, because respondent's claim is secured by a lien and has been fully allowed pursuant to § 502." *Dewsnup*, *supra*, 502 U.S. at 417. Thus, lenders had every reason to rely on the Court's observation "that the creditor's lien stays with the real property until the foreclosure. That is what was

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[3] *See* Federal Reserve Statistical Release Z.1, Financial Accounts of the United States tbl. L-218, ll. 1, 23, at 107 (Dec. 11, 2014) (data on second liens in the residential market).

[4] *E.g.*, Steve Miller, *Amid Quest for Yield, 2nd-Lien Leveraged Loan Issuance Soars*, forbes.com, March 14, 2014, *available at* http://www.forbes.com/sites/spleverage/2014/03/14/amid-quest-for-yield-2nd-lien-leveraged-loan-issuance-soars/.

[5] Standard & Poors, *Leveraged Commentary and Data* (2015).

bargained for by the mortgagor and the mortgagee." *Id.* In sum, under the reasoning of the *Dewsnup* Court, the only criterion necessary for a lien to survive the application of Section 506 is the allowance of the underlying claim. The value an appraiser finds for the collateral at the time of bankruptcy is wholly irrelevant.

Indeed, from the perspective of commercial expectations, the proposed intrusion on the lienholder's interest in these cases would be even more remarkable than the intrusion that *Dewsnup* rejected. The "stripping down" at issue in *Dewsnup* would have left the lien in place, permitting a foreclosure if the borrower failed to pay the reduced debt. By contrast, the "stripping off" that respondents seek would invalidate petitioner's liens ***entirely*** without ***any payment at all***.

The destabilizing effects of an adverse decision in these cases on the $40 billion-dollar market for commercial loans secured by inferior liens are apparent. Lenders to businesses with volatile assets would need to reckon with the likelihood that their liens could be stripped off at any point in time when the value of the collateral fell far enough to justify an appraisal by a bankruptcy judge that would leave their loan wholly "underwater" – preventing any recovery on the loan even if the value of the collateral recovered (or if the appraisal simply was mistaken). Because inferior-lien loans, by definition, reach closer to the margin of collateral value than first-lien loans, concerns about limitations on the customary remedies of the lenders that rely on them are even more chilling than they are in the first-lien context.

Although these cases involve Chapter 7 filings, the effects of lien-stripping under Section 506(d) on the

reorganization of troubled businesses would be even starker. To be sure, a bankrupt firm has the ability in a Chapter 11 plan to limit a secured lender's recovery to the value of its collateral. But Chapter 11 sanctions such a limitation only in the context of the highly structured process for plan confirmation, which provides numerous substantive and procedural protections for the lender. *See, e.g.*, *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S. Ct. 2065, 2069-73 (2012). Automatic lien stripping under Section 506(d), by contrast, would allow the debtor immediately to eliminate the rights of the inferior lienholder, solely on the basis of a judicial valuation, without any recourse to the market tests this Court has found so central to the Chapter 11 process. *See Bank of America Nat'l Trust & Sav. Ass'n v. 203 North LaSalle Street Partnership*, 526 U.S. 434 (1999). In a context where small mistakes in the valuation of collateral could cost lenders tens of millions of dollars, the Court should hesitate before overturning the justifiably long-settled expectations of the affected parties.

II. The Bankruptcy Laws of this Country That Preceded the Bankruptcy Code of 1978 Never Compelled the Holder of a Mortgage to Surrender the Mortgaged Property to the Bankrupt While the Debt Remains Unpaid.

The Court has emphasized that a "sense of history is needed to appreciate" the context of the Bankruptcy Code. *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 540 (1994). Accordingly, we thought it would be useful to the Court's deliberations to discuss the treatment of liens under the various federal bankruptcy statutes that predated the adoption of the Bankruptcy Code of 1978. As the discussion below demonstrates, none of

those statutes gave bankruptcy courts the power to compel a lienholder – holding a senior lien or a junior lien, regardless of the collateral's value – to release its collateral to the debtor while its loan remained unpaid; this Court promptly invalidated the only statute that purported to grant that power. *See Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 581-82 (1934).[6] Rather, as in so many other areas, federal bankruptcy legislation has deferred to state law for the definition of the rights and interests of secured creditors. *See Butner v. United States*, 440 U.S. 48 (1978). Under state law, of course, a creditor's lien is discharged only by repayment of the debt or a foreclosure sale.

A. The Temporary Bankruptcy Acts of the Nineteenth Century Did Not Impair the Rights of Secured Creditors

Before adoption of the first permanent bankruptcy act in 1898, Congress passed temporary bankruptcy statutes in 1800,[7] 1841,[8] and 1867,[9] each in response to a national financial crisis. *See Louisville Joint*

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[6] Before the adoption of the original Frazier-Lemke Act (ch. 869, 48 Stat. 1289 (1934), held unconstitutional in *Louisville Joint Stock Land Bank*, *supra*), "none [of our national bankruptcy acts had] sought to compel the holder of a mortgage to surrender to the bankrupt either the possession of the mortgaged property or the title, so long as any part of the debt thereby secured remained unpaid." *Id.* at 581-82.

[7] Bankruptcy Act of 1800, ch. 19, 2 Stat. 19 (repealed by Act of Dec. 19, 1803, ch. 6, 2 Stat. 248).

[8] Bankruptcy Act of 1841, ch. 9, 5 Stat. 440 (repealed by Act of Mar. 3, 1843, ch. 82, 5 Stat. 614).

[9] Bankruptcy Act of 1867, ch. 176, 14 Stat. 517 (repealed by Act of June 7, 1878, ch. 160, 20 Stat. 99).

Stock Land Bank, *supra*, 295 U.S. at 581-82.[10] Although the drafting of the statutes differed markedly, none had any substantive effects on liens.[11]

First, the 1800 Act provided: "[N]othing contained in this act, shall be taken, or construed to invalidate, or impair any lien existing at the date of this act, upon the lands or chattels of any person who may have become a bankrupt." § 63, 2 Stat. at 36. Similarly, the 1841 Act provided: "[N]othing in this act contained shall be construed to annul, destroy, or impair * * * any liens, mortgages, or other securities on property, real or personal, which may be valid by the laws of the States respectively, and which are not inconsistent with the provisions of the [sections of the statute describing preferences and disallowed claims]." § 2, 5 Stat. at 442. Finally, the 1867 Act provided: "[N]o mortgage of any vessel or of any other goods or chattels, made as security for any debt or debts, in good faith and for present considerations and otherwise valid, and duly recorded, pursuant to any statute of the United States, or of any State, shall be invalidated or affected hereby." § 14, 14 Stat. at 523.[12]

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[10] *See generally* Charles Warren, Bankruptcy in United States History 10-126 (1935); Charles Tabb, *The History of the Bankruptcy Laws in the United States*, 5 ABI L. Rev. 5, 14-15, 16-21 (1995); Stephen J. Lubben, *A New Understanding of the Bankruptcy Clause*, 64 Case Western Res. L. Rev. 319, 343-48, 360-65, 373-78 (2013).

[11] *See Louisville Joint Stock Land Bank*, *supra*, 295 U.S. at 582 (footnote omitted) ("The earlier bankruptcy acts created some exemptions of unencumbered property; but none had attempted to enlarge the rights or privileges of the mortgagor as against the mortgagee.").

[12] Although the language of the 1867 Act protecting liens was less explicit than the language of the earlier statutes, the courts recognized that "§ 14 of the bankrupt law of 1867 * * * is

The courts took those statutes at face value, applying them most frequently in disputes over whether a particular interest was sufficiently choate to amount to a lien. *E.g.*, *Ex parte Foster*, 9 Fed. Cas. 508 (C.C.D. Mass. 1842) (per Story, J.) (concluding that prejudgment attachment did not create a lien for purposes of the 1841 Act); *Waller's Lessee v. Best*, 44 U.S. (3 How.) 111, 120 (1845) (per Taney, C.J.) (Because delivery of a writ of execution to a sheriff perfects a lien under Kentucky law, "the creditor is not deprived of this lien by an act of bankruptcy on the part of the debtor committed [later]."). There was never any doubt that the liens remained unimpaired by the bankruptcy filing. To the contrary, the cases are replete with descriptions of the continuing robustness of the lien after bankruptcy; the underlying theme is that the bankruptcy process takes the liens as it finds them under applicable State law.[13]

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equivalent in effect to a provision in express terms for [liens'] preservation – such as was made * * * in the bankrupt law of 1841." *Leighton v. Kelsey*, 57 Me. 85, 90 (1869). Indeed, the *Leighton* court thought the principle calling for the preservation of liens was so clearly defined in earlier cases that it professed that "one can enter the same field now only as a disciple and copyist." *Id.*

[13] *E.g.*, *Norton's Assignee v. Boyd*, 44 U.S. (3 How.) 426, 436 (1845) (per Taney, C.J.) ("It is quite clear that the liens and mortgages which are valid under the state law must be protected by the District Court of the United States sitting in bankruptcy, and it will not be pretended that the creditor * * * would not have been entitled, under any and all circumstances, to the proceeds of that property to satisfy [the debt]"); *Bellows v. Jenness*, 48 U.S. (7 How.) 612, 622 (1849) ("[T]he words of the proviso [protecting liens] are of the most general and expansive character; they are equivalent to a saving of all liens * * * from any construction of the act [of 1841] that shall in any wise annul, destroy, or impair them"); *Bruner v. Sherley & Sherley*, 27 Miss. (5 Cushm.) 407,

Although litigation under the 1800 Act seems to have been sparse, by the time jurists confronted cases under the 1841 Act, they recognized a crisp distinction between the *in personam* liability of the bankrupt (discharged in the bankruptcy proceeding) and the *in rem* liability of the collateral (which passed through the bankruptcy unaffected). The following discussion from the Mississippi Supreme Court, considering the effect of a bankruptcy discharge on a mortgage reflected in a deed of trust, is illustrative:

> The first question to be settled is, whether the discharge of the appellant from the debt, by his certificate as a bankrupt, extinguished the deed in trust.
>
> It is insisted, on his behalf, that the deed was but a mere incident to the debt, and that whatever discharged the debt necessarily destroyed the deed, because the security could not exist where the debt, which was its foundation and support, was discharged. * * * *
>
> [That] objection is fully met by the second section of the bankrupt act of Congress of 1841, which [makes] it manifest that, while the privilege was granted to the debtor to be personally discharged from the debt, any security which the creditor might have, consisting of a lien on property, was left in as full force as though the debtor had never been

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408-09 (1854) (explaining that despite a discharge under the 1841 Act, liens "were continued in full operation"); *Reed v. Bullington*, 49 Miss. 223, 228 (1873) ("The bankrupt law, as we have seen, preserves the lien of a creditor in full vigor * * * ").

> discharged from the debt, for the security of which the lien was made.

Bush v. Cooper, 26 Miss. (4 Cushm.) 599, 611-12 (1853). Although the statutory description of the discharge in the 1841 Act was broad, courts concluded without exception that the bankruptcy discharge could have no effect whatsoever on the continued validity of the lien.[14]

By the time of the 1867 Act, the topic became a regular feature of this Court's docket. Again, the Court started from the premise that the assignee in bankruptcy (which held the estate of the bankrupt) stepped into the debtor's position with respect to preexisting liens under applicable State law: "Whatever the bankrupt could do to make the assigned property available for the general creditors [the assignee] may do, *but nothing more*, except that he may sue for and recover * * * fraudulent conveyances." *Dudley v. Easton*, 104 U.S. (14 Otto) 99, 103 (1881)

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[14] *E.g.*, *Bellows*, *supra*, 48 U.S. (7 How.) at 623 ("[T]o give full effect to all the provisions of the act [of 1841], the bankrupt's certificate must be made to operate as a discharge of his person and future acquisitions, while, at the same time, the mortgagees * * * shall be permitted to have their satisfaction out of the property mortgaged * * * "); *Kittredge v. Warren*, 14 N.H. 509, 515 (1844) ("[I]f the attachment [lien] is saved by the act [of 1841], the certificate [of discharge] obtained under the act ought not to destroy the attachment."); 1 Peleg Chandler, The Bankrupt Law of the United States, with an Outline of the System § 8, at 16 (1842) (explaining that a lien "within the meaning of the law * * * would not be affected by the subsequent decree of bankruptcy or discharge of the debtor"); *Leighton*, *supra*, 57 Me. at 89 ("[T]he provisions in the bankrupt act [of 1867] are not to be so construed as to prevent the rendition of [a judgment to perfect the lien] in all cases where [the lien was acquired more than four months before the bankruptcy proceeding].").

(per Waite, C.J.) (emphasis added); *see Yeatman v. Savings Institution*, 95 U.S. (5 Otto) 764, 767 (1877) (per Harlan, J.) ("The established rule is that the assignee takes the title subject to all equities, liens, or incumbrances, whether created by operation of law or by act of the bankrupt, which existed against the property in the hands of the bankrupt.").[15]

As it happens, litigation under the Act of 1867 afforded the Court an opportunity to consider the specific question at issue here – whether a bankruptcy discharge vitiates not only the debt but also the lien given to secure it. The issue was squarely presented in the oft-cited decision in *Long v. Bullard*, 117 U.S. 617 (1886). The debtor in that case had filed for bankruptcy under the Act of 1867, and retained ownership of his homestead after that proceeding. When the holder of a pre-bankruptcy mortgage sought to foreclose, Long argued (much like respondents) that the bankruptcy discharge had vitiated not only the debt but also the lien. When the lower court rejected that claim, the Court concluded that "there cannot be a doubt of the correctness of the decision." The Court offered the matter-of-fact explanation that Bullard's

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[15] *See also, e.g., In re Hambright*, 11 Fed. Cas. 314, 315 (W.D.S.C. 1869) ("What is meant by the expression 'estate of the bankrupt'? Evidently such property and rights of the bankrupt as the bankrupt act [of 1867] vests in the assignee. The assignee can take nothing more than the bankrupt himself had in any case, except the case of a fraudulent conveyance."); *Mattocks v. Baker*, 2 F. (2 Hask.) 455, 455 (D. Me. 1880); Orlando Bump, The Practice in Bankruptcy, with the Bankrupt Law of the United States as Amended § 20, at 375 (5th ed. 1872) ("When it speaks of the estate of the bankrupt, it means such estate with all the incumbrances existing upon it at the time of the bankruptcy * * * ").

"security was preserved notwithstanding the bankruptcy of his debtor." *Long*, *supra*, 117 U.S. at 621.

B. The Bankruptcy Act of 1898 Left Liens Unimpaired.

Although the Bankruptcy Act of 1898, ch. 541, 30 Stat. 544, wrought great changes in bankruptcy practice,[16] it did not alter the traditional preservation of liens. Section 67d codified the baseline rule:

> Liens given or accepted in good faith and not in contemplation of or in fraud upon this Act, and for a present consideration, which have been recorded according to law, if record thereof was necessary in order to impart notice, shall not be affected by this Act.

30 Stat. 564. The language was plain and direct, and courts understood it as Congress wrote it. "Section 67d * * * declares that liens given or accepted in good faith and not in contemplation of or in fraud upon this act, shall not be affected by it." *City of Richmond v. Bird*, 249 U.S. 174, 177 (1919).[17]

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[16] *See, e.g.*, Lubben, *supra*, 64 Case Western Res. L. Rev. at 385-90 (summarizing important changes introduced in 1898); Tabb, *supra*, 3 ABI L. Rev. at 23-26 (same).

[17] Like its decisions interpreting the 1867 Act, the Court's discussion of the 1898 Act emphasized the principle that the trustee's position against secured creditors was no better than the debtor's position before the bankruptcy filing. *E.g.*, *Everett v. Judson*, 228 U.S. 474, 479 (1913) (discussing intent "to fix the line of cleavage with reference to the condition of the bankrupt estate as of the time at which the petition was filed"); *York Mfg. Co. v. Cassell*, 201 U.S. 344, 352 (1906) ("Under the provisions of the bankrupt act the trustee in bankruptcy is vested with no better title or right to the bankrupt's property than belonged to the bankrupt at the time when the trustee's title accrued. * * * * The

As with the earlier acts, the 1898 Act rested on a fundamental distinction between the discharge of the debtor's personal liability and the preservation of the liens given to secure the debtor's obligations. That distinction was immediately apparent to the earliest courts to address the new statute:

> [D]ebts which, by their nature, are provable in bankruptcy, are released by a discharge in bankruptcy; that is to say, a discharge in bankruptcy releases the bankrupt from a provable debt * * * and takes away the creditor's right to proceed against him in personam. But * * * such a discharge does not affect a lien on the property of the bankrupt * * * , provided the lien is otherwise valid. A fair construction of the bankrupt act of 1898 leads to the conclusion that the discharge in bankruptcy * * * released the debt secured by the mortgage so far as to enforcement by this creditor in a personal action against [the debtor], but that discharge in no way affected the lien which [the lender] held on the property described in the mortgage.

Evans v. Rounsaville, 42 S.E. 100, 101-02 (Ga. 1902).

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trustee * * * stands in the shoes of the bankrupt, and, as between them, he has no greater right than the bankrupt."); *Thompson v. Fairbanks*, 196 U.S. 516, 526 (1905) (trustee takes "the property of the bankrupt * * * in the same plight and condition that the bankrupt himself had it"); *Hewit v. Berlin Machine Works*, 194 U.S. 296, 302 (1904) ("The present act, like all preceding bankrupt acts, contemplates that a lien good at [the time of filing] as against the debtor and as against all of his creditors shall remain undisturbed.").

The point was so central to operation of the Act that the first edition of Collier's treatise on bankruptcy devoted a separately headed section to it:

> **Discharge Releases Only the Personal Liability.**—Nothing but the bankrupt's personal liability is released by the discharge. Liens upon his [*sic*] property are in no way affected. Whatever their character if they are valid by the laws of the State and not rendered void by the provisions of * * * the bankruptcy act, the bankrupt's discharge will not prevent their enforcement. Thus, in actions to foreclose mortgages the discharge may be pleaded as a defense to the demand for a judgment for any deficiency which may exist, but not as a bar to the foreclosure proceedings.

2 The Laws of Bankruptcy and the National Bankruptcy Act of 1898, ch. 3, § 17, at 155 (W.M. Collier enl. ed. 1899) [hereinafter Collier (1st ed.)].[18]

C. The Chandler Act of 1938 Had No Substantive Effect on Liens.

Bankruptcy practice underwent another major revision with the adoption of the Chandler Act of 1938,

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[18] For a similar contemporaneous viewpoint, see, *e.g.*, 1 Edwin C. Brandenburg & William H. Oppenheimer, Brandenburg on Bankruptcy § 1532, at 1121 (4th ed. 1917).

> Valid and existing liens on specific property or trusts therein securing a debt are not impaired by the discharge.
>
> A discharge in bankruptcy releases the bankruptcy from a provable debt * * * and takes away the creditor's right to proceed against him in personam, but it does not affect a lien on his property * * * provided it is otherwise valid.

ch. 575, 52 Stat. 840, which included a complete recrafting of the provisions related to liens.[19] Again, those changes left intact the principle that a lender cannot be compelled to relinquish its collateral to the borrower until the debt is repaid.[20]

Two provisions of the Chandler Act are relevant. The first is Section 67a, the successor to section 67d of the 1898 Act. Where the drafters of the 1898 Act had made the affirmative statement that the statute had no effect on liens, Section 67a of the Chandler Act protected liens indirectly, by limiting the statute's effects on liens to those obtained "in fraud of the provisions of this Act," Chandler Act § 67a(1), 52 Stat. at 875-76. All agree that the revised drafting "had no substantive effect," *Dewsnup v. Timm*, 502 U.S. 410, 418 n.1 (1992). Rather, the section was reorganized because "the draftsmen of the 1938 Act desired generally to specify only what should be *invalid*." *Id.* (quoting 4B *Collier on Bankruptcy* ¶ 70.70, at 771 (J Moore 14th ed. 1979) (emphasis of *Collier*). As Justice Frankfurter explained, section 67d "was omitted in the

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[19] For overviews of the "comprehensive" revisions made by the Chandler Act, see, *e.g.*, Tabb, *supra*, 3 ABI L. Rev. at 29-30; Lubben, *supra*, 64 Case Western Res. L. Rev., at 385-90.

[20] That is not to say that the 1898 Act left liens unaffected. The statute had a variety of procedural effects on secured creditors. Most obviously, the bankruptcy proceeding stayed all litigation against the debtor, thus bringing to a halt any collection or foreclosure under state law. *See* Bankruptcy Act of 1898 § 11, 30 Stat. at 549; Collier (1st ed.), *supra*, ch. 3, § 11, at 100-14. Similarly, the bankruptcy court also had considerable control over the processes for assessing validity of liens, determining their amount, and liquidating the collateral, at least if the creditor chose to participate in the proceeding. *See Isaac v. Hobbs Tie & Timber Co.*, 282 U.S. 734, 737-39 (1931).

1938 revision because its wording permitted inferences that by negative implication it disallowed certain liens not otherwise invalidated by the Act, and because the substance of the provision was thought to be preserved in other sections—not because of disapproval in policy." *Simonson v. Granquist*, 389 U.S. 38, 43 (1962) (dissenting opinion).[21]

The most important innovation of the Chandler Act's treatment of liens was the introduction of new Chapters X, Chandler Act § 101 et seq., 52 Stat. at 883-905, and XI, Chandler Act § 301 et seq., 52 Stat. at 905-16.[22] Those provisions, the predecessors of the modern Code's Chapter 11, 11 U.S.C. § 1101 *et seq.*, authorized plans of reorganization that could alter the rights of creditors. *See* Chandler Act § 216(1), 52 Stat. at 895-96 (permitting the inclusion "in respect to creditors * * * , secured or unsecured, * * * [of] provisions altering or modifying their rights"). Because those provisions applied only in plans of reorganization, they would not have compelled a release to the debtor itself; then as now, the absolute priority rule would compel the elimination of any

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[21] *See Goggin v. Division of Labor Law Enforcement*, 336 U.S. 118, 126-27 (1949) (discussing "the general purpose of Congress [in adopting the Chandler Act] to safeguard interests under liens perfected before bankruptcy"); *Oppenheimer v. Oldham*, 178 F.2d 386, 389 (5th Cir. 1949).

[22] The Chandler Act's provisions for plans of reorganization were not entirely novel. Congress had amended the Bankruptcy Act of 1898 five years earlier to permit "compositions" that affected the rights of secured creditors. *See* Act of Mar. 3, 1933, ch. 204, § 1, 47 Stat. 1467, 1467. *See generally Louisville Joint Stock Land Bank*, *supra*, 295 U.S. at 586 n.16 (discussing those provisions). Those provisions, however, authorized no impairment of the unconsenting holder of a mortgage lien. *See id.*, 295 U.S. at 585-86.

equity interest of the original debtor in any case that impaired the interest of an unconsenting secured creditor.[23] Thus, although it was more intrusive than its predecessors, the Chandler Act did not go so far as to compel a creditor to relinquish its collateral to its borrower until the loan was repaid. More fundamentally, as with present-day Chapter 11, the Chandler Act permitted modification of a secured creditor's lien only upon compliance with the procedural and substantive protections afforded by a plan; it did not permit the automatic lien-stripping accepted by the court of appeals.

D. The Frazier-Lemke Act Did Limit the Value of a Creditor's Lien, but This Court Held It Unconstitutional.

To be sure, one pre-Code enactment did purport to limit the ability of secured creditors to retain their liens through a bankruptcy proceeding. Enacted in an effort to stem the flood of farm foreclosures related to the Great Depression, the Frazier-Lemke Act, ch. 869, 48 Stat. 1289 (1934), sharply limited the remedies available to mortgage lenders. Among other things, the statute allowed a borrower to retain a farm, free of a lien, if the farmer tendered into the court the value of the property as appraised. *Id.* at 1290 (codified at 11 U.S.C. 5(s)(7) (1936)). That provision had only limited effect, however, because this Court – emphasizing how far Frazier-Lemke went beyond the

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[23] *See Northern Pacific Railway v. Boyd*, 228 U.S. 482, 502-10 (1913); *Kansas City Terminal Railway v. Central Union Trust*, 271 U.S. 445, 453-56 (1926); *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 114-32 (1939); Douglas Baird & Robert Rasmussen, *Boyd's Legacy and Bankruptcy's Ghost*, 1999 Sup. Ct. Rev. 393, 397-408.

bounds of traditional bankruptcy rules – held the statute invalid as a taking of the property interests that lenders held in their collateral. *Louisville Joint Stock Land Bank*, *supra*, 295 U.S. at 589-602.

The centrality of the lender's right to retain the entire value of its lien was underscored by the Court's treatment a few years later of the revised Frazier-Lemke Act, ch. 792, 49 Stat. 942 (1935). In concluding that the revised statute was constitutional, the Court emphasized that the revised statute preserved "[t]he right to retain the lien until the indebtedness thereby secured is paid." *Wright v. Vinton Branch of Mountain Trust Bank*, 300 U.S. 440, 457 (1937). Indeed, the opinion of Justice Brandeis went out of its way to emphasize that pre-enactment "[a]mendments to the bill subsequent to its introduction plainly demonstrate careful intention to leave the lien wholly unimpaired." *Id.* at 458 n.2. As Justice Brandeis explained, the original bill would have obligated the lender to accept the appraised value of the collateral (the same course of action that respondents advocate); the statute was revised before adoption because of concerns that such an intrusion on the rights of secured lenders would amount to an unconstitutional taking of property. *Id.* Only with that amendment did the statute pass this Court's constitutional scrutiny.

One thread runs through all those decisions and the statutes that they construe: the principle that liens pass through bankruptcy unaffected – except in the carefully cabined circumstances of modern-day reorganization proceedings – has deep roots in the common law, the bankruptcy statutes, and the Constitution. It applies to all liens, regardless of their priority, regardless of the value of the collateral that secures them.

CONCLUSION

Rejection of *Dewsnup*'s application to inferior liens would fly in the face of historical practice and destabilize a crucial sector of our all-too-fragile lending markets. We respectfully submit that the Court should reverse the decisions of the court of appeals.

Respectfully submitted,

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January 2015